



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Number: 201150034
Release Date: 12/16/2011
Date: September 21, 2011

Contact Person:
Identification Number:
Contact Number:
Employer Identification Number:
Form Required To Be Filed:
Tax Years:

UIL: 501.03-05; 501.06-00; 501.06-02

Dear :

This is our final determination that you do not qualify for exemption from federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Since you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

Letter 4038 (CG) (11-2005)
Catalog Number 476328

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois Lerner
Director, Exempt Organizations

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: August 2, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

M = company
B = individual
C = individual
D = individual
E = individual
F = individual
G = date
H = date
J = company
K = individual
L = city
P = company
Q = program
x = date
y = state
z = address

UIL Nos:

501.03.05
501.06.00
501.06.02

Dear :

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

ISSUE

Do you fail to qualify for exemption from federal Income tax under section 501(c)(3) of the Internal Revenue Code due to the commercial nature of your activities? Yes, for the reasons described below.

Do you fail to qualify for exemption from federal Income Tax under Section 501(c)(3) of the Internal Revenue Code as your activities constitute a substantial non-exempt purpose? Yes, for the reasons described below.

FACTS

You were incorporated in y on x. Individuals B, C, D, E and F are listed as your officers with individual B as your CEO and Director.

Your will operate a coffeehouse with the goal of providing the local community with a social and entertaining atmosphere where people can meet each other in a safe, warm and comfortable environment. A separate but related church entity will be run out of the coffeehouse. You hope to assist the church to be seen as a church body truly concerned for the community and that practically seeks to address the community's concerns where it can. You will channel resources into local and international charities in order to help make our world a better place and gain a hearing for sharing God's love.

Your coffeehouse will be a multimedia café that serves as the primary connection point for the surrounding community. It will provide a relaxing, community-focused, neighborhood-centered place with freshly roasted international coffee, specialty coffee drinks, good books, free Wi-Fi access, and TV screens.

You will accomplish your mission in the following manner:

Coffee – Coffeehouse will serve gourmet coffee and tea. The beverages will be of the utmost quality and excellence. People in your community will seek you out because they will know you offer the best coffee in the area as well as providing a great ambiance to enjoy their coffee. Warm and welcoming will be the “feel” of the coffeehouse as you seek to interact with your community.

Local/Community Needs – You will donate resources to local charities and non-profit organizations like food pantries and clothes closets. You will raise awareness of need in the local community and think of creative ways in providing for that need. Some examples of resources provided would include proceeds from coffee sales, benefit concerts, food drives, etc. You will seek out opportunities to positively impact and make better your community.

International Needs – Examples of this kind of aid would be digging wells in countries that need fresh drinking water and malaria nets for communities to prevent an AIDS/HIV outbreak. You want to help bring awareness of global issues and needs in order to bring about tangible ways to help resource and eliminate these concerns.

Seminars – The coffeehouse will provide a forum where many different topics are covered in order to help people better understand their lives and purpose. Such seminar topics will be finances, marriage, parenting, work, etc. You will provide these seminars for the community in order to help bring health and healing to people who would benefit from these varieties of topics.

Community Hub – All these activities act to bring the community together at the coffeehouse and help provide them a space to meet. Each activity is headed up by their own leadership group such as:

Youth - Youth groups and other youth-oriented programs will be able to use the facilities for whatever they'd like.

Home Ownership Associations (HOA) groups – HOA groups are always looking for a place to hold their quarterly meeting and you will provide a warm and relaxed environment for them to have their meetings.

Church groups – The coffee house will be big enough for churches to use for worship services and whatever other meetings they desire to have.

Charities – Work with local charities and provide space for them to hold meetings or events for their causes.

Office Space – A portion of the facilities will have a couple of offices in it to serve local churches or businesses for smaller needs.

Tutoring – You will provide a place where students of all ages can be tutored by licensed teachers in your area. This location would serve as a central meeting place for tutoring to take place.

Pop Culture Discussion Group – Will also engage the community with dialogue about current cultural trends in movies, music, and literature.

Revenue will be mainly from gross receipts generated through the operation of the coffeehouse but you do expect some outright donations. You project approximately \$ _____ of income for your first few years. Expenses will cover primarily salaries and occupancy expenses related to the operation of the coffeehouse. You project approximately eight percent of expenses will go towards charitable distributions.

The coffeehouse will be open daily from 6am-2pm and in the evenings based upon scheduling specific events. You eventually want to be open from 6am-10pm. The coffeehouse will initially employ three baristas, all part-time, with pay ranging from \$8.50/hr to \$9.50/hr based upon experience. Each of the baristas will primarily make coffee and tea drinks, provide great customer service, and look after the cleanliness of the coffeehouse.

Your menu will include a variety of coffee, tea and pastries with prices ranging from \$2 to \$4 per item.

Events can be scheduled anytime during the day or evening. Space will be available for artists, musicians, weddings, special parties, HOA meetings, etc.

You provided a brochure Titled M Coffeehouse, with a buy one drink get one free card attached, with the following:

You are invited to a NEW neighborhood COFFEEHOUSE!

- Gourmet locally roasted coffee from P.
- Free Wi-Fi and comfortable seating – Relax, read, or chat at the bar.
- A Community environment – Great for work or social gatherings.
- Live music during the evenings – New local artists are welcome.
- Kid friendly – Enjoy a Latte and let the kids enjoy our playroom.
- Proceeds of Every cup sold goes back to local charities and community aide organizations –“Q” never tasted SO good!

The brochure stated your location as z.

Other items provided include: One gift certificate of \$5, One coffee card buy 7 coffees and get 1 free, and a business card with individual B's name and title as director with telephone number and email address that included your location's address.

You provided a copy of your VIP event invitation that states:

A non-profit, community gathering place with great coffee, amazing people and a cause!!

M's Coffeehouse, at z

We hope you're able to come by and have a delicious cup of coffee and see the impact we're having in our community and world.

You are Very Important! (to us)....so, we're inviting YOU to our M Coffeehouse VIP Pre-Grand Opening Preview Event!

Our mission is to support the local and global community by giving a portion of our profits as well as personally volunteering and serving.

This VIP event is an opportunity to get to know and better serve you!

You indicated that 65% of your expenses will be for the local community while the remaining 35% will be for international aid, however, projections show between 8-15% percent for charitable distributions.

Your web-site provides a description of your specialty coffees that are sold and your coffee menu. The web-site states you will donate a portion of every purchase to a local or international charity or organization seeking to make a difference in our world, one cup at a time. Your web-site states "come by see what group we're partnering with for the month and participate with us extending help in this very tangible way". Your web-site also stated that "we want to meet you and have M be your regular coffee connection. Please let us know how we can serve you".

You will charge for booking events at your coffee house for artists, musicians, weddings, special parties, HOA meetings, etc. Costs will vary depending on what services are needed. Rental alone will run approximately \$25 to \$50 an hour (depending on the size of the group and how much set-up, cleaning, and tear down there is). You will provide paid employees based on the events. If the event requires a staffed coffee bar than employees are paid an hourly wage plus tips. The hours depend on the event. Rental plus staffed coffee bar will be approximately \$85 an hour.

No catering services are provided, however, if someone wants to bring in outside catering for an event, you are open to that. You will sell coffee during events and the prices will be the same as normal business hours.

Your coffeehouse had a VIP Event, which was an evening designed to introduce M's coffee to the community and to bring out local leaders of schools, churches, charities, businesses, and government to show appreciation to community leaders. The event was free for the local leaders. All costs and expenses for the event were taken care of by M Coffee.

If the event involves an artist you will display artwork that is available for sale. You will receive 20% of sales with it being split (10% of sales going to you and the other 10% going to a charity).

You provided a lease agreement that reflected J as the landlord and you as the tenant. The terms of the lease agreement will be three years and four months beginning on G and ending on H. The lease agreement was signed by individual K, who signed as manager of J and individual B, as your CEO and director. Your lease agreement states that the premises shall be used and occupied by tenant, continuously and without interruption,

solely for a coffee shop. The landlord shall not lease to another tenant within the subject shopping center whose primary use is a coffee shop. Your lease agreement states that the tenant shall be allowed to use patio space for outdoor seating so long as:

- Use does not restrict pedestrian access throughout sidewalks,
- All seating is approved by the City of L, and
- Outdoor seating does not restrict, limit or interfere with any of the other tenants' ability to do their business, and
- Nothing is installed permanently to the ground that can not be removed without Causing damage to the property.

LAW

Section 501(c)(3) of the Internal Revenue Code provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Regulations states that in order to be exempt as an organization described in Section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organization test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the Regulations states an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(e)(1) of the Regulations states an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose.

Rev. Rul. 68-72, 1968-1 C.B. 250, states that a nonprofit organization that operates a supervised facility to bring together young people of college age with church leaders, educators, and leading businessmen of the community may be exempt from federal income tax under section 501(c)(3). The organization was formed by local churches for the purpose of furthering the religious, intellectual, and moral development of persons of college age through the operation of the "coffee house", a supervised facility where church leaders, educators, and leading businessmen of the community meet and mingle with young people in an informal atmosphere. They hold discussions on such subjects as

religion, current events, and social problems. Personal counseling and vocational guidance is provided. Nominal charge is paid upon admission, but there are no additional charges for the refreshments and entertainment. The organization meets its expenses from contributions and the admission charges.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

In American Institute for Economic Research v. United States, 302 F. 2d 934 (Ct. Cl. 1962), the Court considered an organization that provided analyses of securities and industries and of the economic climate in general. It sold subscriptions to various periodicals and services providing advice for purchases of individual securities. The court noted that education is a broad concept, and assumed *arguendo* that the organization had an educational purpose. However, the totality of the organization's activities, which included the sale of many publications as well as the sale of advice for a fee to individuals, was indicative of a business. Therefore, the court held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose, and was not entitled to be regarded as exempt.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the Tax Court held that an organization did not qualify for exemption under section 501(c)(3) of the Code because it was primarily engaged in an activity that was characteristic of a trade or business and ordinarily carried on by for-profit commercial businesses. The Tax court Stated:

We must agree with the Commissioner that petitioner's activities constitutes the conduct of a consulting business of the sort which is ordinarily carried on by commercial ventures organized for profit.

In Airlie Foundation v. I.R.S., 283 F. Supp. 2d 58 (D.D.C. 2003), the District Court found that that the organization was formed principally to organize, host, conduct and sponsor educational and other charitable functions on its facilities. The organization's patrons were not limited to tax-exempt entities, but included patrons of a private and corporate nature. The organization paid significant advertising and promotional expenses and derived substantial income from weddings and special events held at its conference center. The court determined that the organization's activities competed with a number of commercial, as well as non-commercial entities, which strongly evidenced a commercial nature and purpose. The court concluded that although the organization carried out a number of charitable and educational activities, these were incidental to its primary activity of operating a for-profit conference center.

Application of Law:

You are not operated for exempt purposes consistent with Section 501(c)(3) of the Code. Your activities consist of operating a commercial coffeehouse. You advertise to the public in a manner consistent and in competition with other for-profit coffee establishments. Literature provided demonstrates that you charge market rates for your coffee products in a manner indistinguishable from a commercial venture. These facts demonstrate a commercial and substantially non-exempt purpose inconsistent with Section 501(c)(3) of the Code.

Per 1.501(c)(3)-1(e)(1) of the regulations, an organization may qualify for exemption even though it operates a trade or business. You are organized and operated for the primary purpose of carrying on an unrelated trade or business through the operation of your coffeehouse. Although you conduct some charitable activities you also serve substantial social and recreational purposes. Because the coffeehouse is operating for purposes inconsistent with exclusive 501(c)(3) activities you do not meet the specifications of this regulation. As a result, by sections 1.501(c)(3)-1(a)(1) and 1.501(c)(3)-1(c)(1) of the regulations, you do not qualify as you are not organized and operated exclusively for one or more exempt purposes and a substantial part of your activities is of operating a trade or business.

You are distinguishable from Revenue Ruling 68-72 in that the majority of your activities are to operate your coffeehouse in a commercial manner. Your product advertisements focus substantially on your market priced products. Finances are devoted to the upkeep and expansion of your coffeehouse. These factors directly contrast with the cited ruling which granted exemption to an organization formed by local churches, devoted an exclusive amount of time to religious studies, and charged nominally for admission with no further product cost.

Your operation of a coffeehouse constitutes common commercial activities, rather than activities that further charitable or educational purposes. Your operations are similar to those described in B.S.W. Group and Airlie Foundation, as your services are competing with a number of non exempt commercial, for profit companies through your product pricing pattern, compensated staff, and commercial advertising pattern.

You are similar to organizations described in the court cases Better Business Bureau and American Institute for Economic Research. In each of these two cases, the particular organization was found to operate in a substantially non-exempt manner due to the commercial nature of their activities. Your operations reconcile to these rulings as your primary purpose is running and renting of your coffeehouse at commercial rates with little to no exempt purpose consistent with Section 501(c)(3) of the Code.

Conclusion:

You do not meet the requirements under section 501(c)(3) because your operation of a coffeehouse is consistent with running a trade or business and not that as described in the Code. We find that you operate for non-exempt commercial purposes. In addition, we have determined that you have failed to establish that your activities further a tax-exempt purpose within the meaning of section 501(c)(3) of the Code. Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code.

Consideration was given to whether the applicant organization qualifies for exemption under other subsections of section 501(c) of the Code. However, based on the information that you have submitted, we cannot find that you are entitled to exempt status under section 501(c) of the Code because you are operating for a significant non-exempt commercial purpose.

Based on the above facts and law, we conclude that you do not qualify for exemption under section 501(c)(3).

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892; *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". These items include:

1. The organization's name, address, and employer identification number;
2. A statement that the organization wants to appeal the determination;
3. The date and symbols on the determination letter;
4. A statement of facts supporting the organization's position in any contested factual issue;
5. A statement outlining the law or other authority the organization is relying on; and
6. A statement as to whether a hearing is desired.

The statement of facts (item 4) must be declared true under penalties of perjury. This may be done by adding to the appeal the following signed declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois Lerner
Director, Exempt Organizations

Enclosures
Publication 892